Assessment of China and Nigeria Currency Swap:
The Positive Impacts on the Nigerian Economy

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Abstract: It is noteworthy to pinpoint that historical self-evidence have demonstrated that many Countries have employed currency swap strategic weapon to stabilize their currencies; atypical example was currency swap between China and Argentina which helped both Countries to stabilize their currencies. Again the U.S. foreign Reserves engaged in an aggressive swap strategy with European Central Banks during 2010 European financial crisis to stabilizes the euro, which was failing in value due to the Greek financial crises. Nigeria being a mono-foreign exchange earner based solely in exportation of crude oil to the world market, therefore, it is imperative, the ebh and flow of the price of crude oil in the International Market will surely affect the foreign exchange earnings of the country.

In view of the above, it becomes absolutely, an economic strategic importance for Nigeria to adopt currency swap strategy to stabilize its currency and with other advantages that may accrue to the economy. Specifically, Nigeria is to enter into currency swap agreements with China with the understanding that it will help her to stabilize the currency more especially when there is a fluctuation in the price of the world oil market.

The paper is therefore anchored on the examination of histories of different counties, which have embarked on currency swaps, it will also critically analyze the mechanism of the currency swap and subject the positive and negative impacts of the currency swap of Nigeria and China agreement into deeper economic analysis. The paper will also go a long way to insightful and incisively proffer and recommend possible solutions to the problems that may be encountered in the formulation and implementation of the swap deal.

I. INTRODUCTION

It has to be mentioned that oil and gas constitute the major foreign earnings of Nigeria and central pillar on which Nigerian economy is based; the nose-diving of the oil prize between 2014 to early 2016 to the extent that world crude oil price dropped from $73.75 to $44.50 in mid-January 2015, posited critical negative effects on the foreign reserve of Nigeria. Worst still, Federal Government of Nigeria never saved the surplus inflow of funds during the oil price boom to reduce the negative effects on the economy when the price started to plummet. The net effect was acute shortage of the foreign exchange earnings to take care of the imports thus the need to conserve the scare foreign earnings which constitutes the backbone of the economy. To manage the acute shortage, Central Bank of Nigeria (CBN) Authorities decided to adopt a fire brigade approaches and in some cases policies that were not within a known economic framework as essential panacea to mitigate the situation. It must be mentioned that architecture of controls were put into place to ensure effective management of the reserve namely: banning the use of currency within the country, restricting currency exchange to government- approved agents: banks and bureau de change, further the bureau de change were charged to source their own foreign currency, fixed exchange rates, and restricting the amount of the currency that may be imported and exported were put in place and none approval of paying school fees and hospital bills in foreign currency were enforced.

In view of the above, in 2019 the CBN decided to enter currency swap with China on behalf of Nigeria, It is not arguable that the China and Nigeria currency swap will play a major role in conservation of foreign currency and with the view that critical sector of the economy will get the required boast.

Investpedia defined a swap as a derivative contract through which two parties exchange the cash flows or liabilities from two different financial instruments. Most swaps involve cash flows based on a notional principal amount such as a loan or bond. Each cash flow comprises one leg of the swap. The most commonly ones are Interest Rate Swaps and Currency Swaps.

1. In an interest swap, the parties exchange cash flows based on notional principal amount (this amount is not actually exchanged) in order to hedge against interest rate risk or to speculate.

2. In a currency Swap, the parties exchange interest and the principal payments on debts denominated in different currencies. Unlike an interest rate swap, the principal is not notional amount, but it is exchange along with interest obligation. Currency swaps can take place between countries. For example, China has used Swaps with Argentina, helping the latter stabilize its foreign reserves. Investpedia (2019) And Nigeria and China are in currency arrangement, Nigeria hoping it will stabilize its currency among other advantages.

The currency swap is therefore an agreement between two parties to exchange the cash flows of on party’s loan for other of a different currency denomination. They allow companies to exploit the global capital markets more efficiently because they are an integral arbitrage link between interest rates of different developed countries.(GGAND SOORAN/CONTRIBUTOR,(2019). However, a currency
swap in finance is termed a cross-currency swap is seen as interest rate derivatives which really involves multiple currency simultaneously. According to Wikipedia a cross-currency swap’s is define as a derivative contract, agreed between two counterparties, which specifies the nature of an exchange of payments benchmarked against two interest rate indexes denominated in two different currencies. It also specifies an initial exchange of notional currency in each different currency and terms of that repayment of the national currency over the life of the swap. (J. H. M Darbyshire (2017)).

A currency swap may be seen as an off-balance-sheet transaction in which two parties exchange principle and interest in different currencies. The parties involves in the transactions are normally financial institutions on behalf of two parties. In the case of Nigeria Central Bank are the arrow head of the transaction and the Agent of the country, while that of China is being spearheaded by Peoples Bank of China (PBoC). Specifically, the main objective of the currency swap is to hedge exposure to exchange rate risk or reduces the cost of borrowing a foreign currency and to appreciate ones country currency.

A currency swap is therefore, a foreign exchange derivative between two institutions to exchange the principal and/or interest payment of a loan in one currency for equivalent amounts, in net present value terms, in another currency. Currency swap was motivated by comparative advantage of borrowing markets.

It should be noted they are two kinds of currency swaps: The fixed-for-floating swap, fixed interest payments in one currency are exchanged for floating interest payments another. It should be noted that in the later type of swap, the principle amount of the underlying loan is not exchanged. (Investpedia). This is explained very clearly under.

In practical terms, it should be noted in currency swap, on the trade date, the counter parties in this case Nigeria and China will exchange notional amounts in the two currencies such as Naira and Yuan. Nigeria will receive 20 million China Yuan which Nigeria will review upward based on the current exchange rate of China currency to Naira to close the deal.

The most economical possibility is that the businessmen in Nigeria and China can engaged in currency swap with a Chinese businessman who may need Naira to fund operation in Nigeria, while Nigerian businessmen will need to purchase goods in China. The two businessmen will now come to an agreement where both parties will get the cash they required without going to the banks for loans. The latter option would have undoubtedly increase their debt bundle more especially transacting business in other currency will inevitable increase their costs of operations as well. The need for the transaction will be reinforced as makes each party to know what to pay at point of transaction which is very necessary for budgeting and planning and necessary for business success for both companies in the different countries.

In Nigeria case according to the statement issued by the CBN, that the sale of foreign exchange under the agreement would be done through the combination of spot and short tenured forward. And it will be in the form of Special Secondary Market Intervention Sales Retail and would be dedicated to the payment of Renminibi denominated Letters of Credit for raw materials and agriculture.

Mr. Isaac Okoroafor issued a statement that “ the CBN would also not be applying the relevant provisions of the Guidelines which equally provide that Spot foreign exchange sold to any particular end-user shall not exceed one percent of the overall available funds on offer at each SMIS” continuing on the funding mechanism he stated that authorized dealers would be required to debit the customer’s account for the naira equivalent of their bids and the authorized dealers would be debited by CBN on the of intervention to the tune of Naira equivalent of their bid request.” He continued to stress in his statement that there would be no predetermined spread on the sale of Forex Forward by Authorized Dealers to end users under the Special SMIS-Retail. He mentioned that Authorized Dealers would be allowed to earn 50 kobo on the customers bid.

To be more explicit it is pertinent to state the requirement of Memorandum of 9 of the FX Manual, documents submitted by the participants at the CBN Renminibi bidding sessions shall comply with the following:

1. Letters of Credit transactions are to be undertaken in such all negotiating documents and/or shipping documents are routed from the beneficiary/supplier through his/her bank to issuing bank. Banks are therefore prohibited from endorsing or making payments in respects of documents which are not in compliance with stipulated routing.

2. Bills for Collection transactions are to be carried out in a way that allows all necessary documents to be routed to the issuing bank either directly from the supplier’s or though the offshore correspondent of the issuing bank.

3. Transactions “Not valid for Foreign Exchange” shall be conducted in way that all supporting documents are routed by the supplier directly to the applicant’s bank that is responsible for validating the underlying “e-Form M”

II. HISTORICAL FRAMEWORK

The Central Bank of Nigeria (CBN) to get the best for the country by embarking on currency swap with China must learn from the historical success of other countries.

According to Wikipedia in the 1990s Goldman Sachs and other US banks offered Mexico, currency swaps and loans using Mexican oil reserves as collateral and as a means of payment. However it must be noted the in the case of Mexican...
the oil was valued $23.00 per barrel. This has some collaboration/similar transaction with Nigeria and China currency swap as China is offering Nigeria through CBN, however with bank as the correspondent bank, and in the currency swap agreement with the possibility of loan and oil as collateral.

It was 1970 that currency swaps were initiated with the main objective to circumvent foreign control in the United Kingdom because United Kingdom companies had to premium to borrow in US dollars. Coyle, Brain (2000) noted that to avoid paying the premium, UK companies set up back-to-back loan agreement with US companies wishing to borrow Sterling. While such restrictions on currency exchange have since became rare, however companies can gain comparatively by embanking on back-to back loans transactions.

During the global financial crisis of 2008, the USA Federal Reserve System initiated the currency swap transactions structure to establish central bank liquidity swaps. Chan, Fiona (2008) noted that in these, the Federal Reserve and the central banks of developed or stable emerging countries economy agree to exchange domestic currencies at the current prevailing market exchange rate and agree to reserve the swap at the same exchange and at a fixed future date. The critical objective of the swap transaction by the Fed Reserve and the Central Banks was to provide liquidity in US dollars oversees market. It should be noted that currency swap in most often than not are commercial transactions driven by comparative advantage.

The People’s Republic of China has multiple year swap agreements of Renminibi with Argentina, Belarus, Brazil, Hong Kong, Iceland, Indonesia, and Malaysia. Russia, Singapore, South Korea, United Kingdom, Uzbekistan that perform a similar function to central bank liquidity swaps.

In October, 2013 South Korea signed a one-rupiah currency swap deal worth US$ 10 billion. It was agreed that the two countries can exchange up to 10.7 trillion won or 115 trillion rupiah for three years. The three –year currency swap could be renewed if both sides agree at the time of expiration. It is anticipated to promote bilateral trade and strengthened financial cooperation for the economic development of the two countries.

Finally Japan and India signed a currency swap agreement worth US$75 billion in October, 2018, which has been one of the largest bilateral currency swap agreement according to Economic Times Magazine.

Consequent upon, the CBN in 2017 declared its attention to have currency deal with China, however the currency swap between Nigeria and China started in July 2018. The CBN choses four banks Stanbic IBTC, Zenith Bank, First Bank and Standard Chartered Bank, the four banks will act as settlement/correspondent banks for settling the trade transactions between importers and exporters from both countries accordingly to the CBN; the four banks were selected based on their footprints in mainland China. First Bank and Zenith have representative offices in Beijing while Standard Chartered Bank and Stanbic IBTC have operational offices in China. It must be stated that Stanbic IBTC, however, has strong footprint in China; it has a direct link with the Industrial and Commercial Bank of China (ICBC). ICBC owns 20 percent stake in Standard Bank while Standard Bank owns over 64 per cent of Stanbic IBTC, this is the main reason Stanbic Bank was chosen as a correspondent bank for Chinese end.

We have to note that the swap currency is an agreement with three year tenor which allows both the CBN and the Peoples Bank of China (PBoC) to swap a maximum of amount of fifteen Billion Renminibi/Chinese Yuan (CYN 15billion) for Seven Hundred and Twenty Billion Naira (NGN720billion) and the amount is equivalent to US$2.5 billion using official exchange rate of NGN305, according to Seyi Bella et al (November 20, 2018). However, CBN pinpointed that main value-focused policy objective of Currency Swap agreement was to put in place a mechanism to provide trade and investment between China and Nigeria, maintain financial stability and more importantly facilitate other connected purposes as may be agreed upon both countries.

III. POSITIVE IMPACTS OF THE CURRENCY SWAP ON ECONOMY

It is envisaged that currency swap deal will provide foreign exchange liquidity in the economies of both countries: Nigeria and China as well. Consequently upon, provides Naira to the China businessmen who want to invest in Nigeria while also providing China Yuan to Nigerians who want to purchase goods and to transact business in China. According to Seyi Bella et al “The Currency Swap Agreement between China and Nigeria will remove the need to first source for the ‘greenback’ (US Dollars) before transactions involving the two countries can be made”.

Also the Managing/Chief Executive Officers of Cowries Investment limited, Johnson Chukwu explained that the currency swap scheme would address short term basis, the current liquidity challenge in the Nation’s foreign exchange market, he went further to point out “with the currency swap, depending on the value, a significant portion of Nigeria’s import bill from china would now be dominated and settled in Yuan, thereby reducing the demand for dollar by Nigeria’s importers.

Hence, the demand for dollar will be reduced, more specially in Nigeria for purchases in China or to transact business in Nigeria, it means that the transaction will actually reduce the demand for dollar in the FX market and the net result is to appreciate Naira against dollar. According to Helen Oji (2018) “the deal is expected to reduce the demand for US dollar by Nigerians importing from China, and consequently strengthen the value of the Naira. The deal will reduce certain barriers for Nigeria importers of goods from China as well as the cost of

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transactions in multiple currencies” It will therefore facilitate transactions between the two counties, without the use of dollar. That will actually lead to the reduction of the cost of the imported goods, and the effects will be fundamental in the economy as about 70 percent of Nigeria imports from China, and it is predicated upon to lead to reduction of the rate of inflation. This is premised on the predictability of both countries to gain robustly in the deal; the domestic company is able to locally access finance at better terms compared to foreign companies. The foreign companies in China will also transact business with Naira instead of sourcing for dollars.

The swap scheme is a potent tool to reduce risks of companies and firms operating in both counties. It is envisage that currency swap agreement will make it possible for the China companies operating in developing country like Nigeria to reduce to a considerable extent exposure to risk through currency functions. It will reduce the fluctuation risk because currency swaps inject certainty in the foreign Exchange (FX) market, more importantly hedge exposures to exchange rate risk.

The Scheme will play a pivotal role in the management of external reserve which is very strategic to the economy of Nigeria. Accordingly, CBN listed one of the major advantages of the currency swap “it will also assist both counties in their foreign exchange reserves management, enhance financial stability and promote broader economic corporation between the two countries” CBN 2018, the point stands that it will lead to exchange rate stability.

It will encourage the growth of the SMEs. Accordingly, to Adebayo Sanni-Omotosho (2019) it is believed that a large portion of the deal should go to what will put the necessary infrastructure in place to support the SMEs and provide the machinery to aid value-chain production (and maybe, some consumable that are not readily available for production in Nigeria). He went further to stress that SME’s output is another input until it reaches a stage where the goods are ready for export or local consumption. It will create value to all parties concern in all the swap transactions. This value chain will lead to the provision of the raw materials to some of our manufacturing industries in Nigeria while also encouraging a massive exportation of raw material which will yield foreign exchange.

Another important point that needs to be mentioned the deal will be a vehicle for the development of SMEs, the transaction makes easier for the businessmen in Nigeria to have enough foreign exchange to transact its business and therefore encourage the development of the small and medium scale enterprises (SMEs) and export businesses. This point is corroborated by the CBN spokesman Mr. Okorofor Isaac, “these categories of the business will take advantage of available Reninimbi liquidity from Nigeria banks under the swap deal to pursue their business without being exposed to the hassles of seeking other scarce foreign currencies which attract higher interest rate.”

The deal may also aid agricultural productions which are the bedrock of economic diversifications, as it will make exportation of agricultural raw material to China to be very easy, the businesses of the China can have enough Naira to purchase Nigeria agricultural raw materials without going through third party currency like dollars. Okorofor went further to note that the deal, which is purely an exchange currencies would also make it easier for Chinese manufacturers seeking raw material from Nigeria to obtain Naira from banks in China to pay for imports.

The currency swap deal is one of the strategies adopted by the CBN to overcome the stress and frustration encountered by businesses in getting finance for contacts and deals through local commercial banks. Under the swap arrangements business men or companies and contactors can approach any of the accredited banks to request for credit facilities to execute a contract which make it easily for building of infrastructure’s in the county because major infrastructures contact such as railway system, roads, power, water, hospitals, petro-chemicals, plants, airport terminal, as well as projects in the oil and gas will be financed through counterpart funding of such contracts. It will therefore act as a catalyst of agricultural development.

The swap scheme is a motivating factor to make Nigeria the trading and commercial hub of West African counties if not in Africa, as majority of the imports from China will be at most competitive price, noting the fact that 70 percent of imports bills will be domiciled in Chines currency. The macroeconomic implication of the transaction has the ability to stimulate massive employment opportunities in Nigeria thereby depressing unemployment which is almost 18.13 percent in Nigeria, this is conservative estimate. It therefore holds great prospects to grow the economy of Nigeria and lay solid foundation for sustain able economic take off. Deputy Chinese Ambassador to Nigeria, Lin Jing, said Nigeria is Chinese biggest investment destination in Africa as well as the second largest export market and the third largest trading partner.

One of major problem facing Nigeria economy, almost 90 percent of the foreign earning is realized from the exportation of crude oil to the International Market. The growth of the economy is subjected by the ebb and flow of income realized from the crude oil. In other words, the currency swaps will actual lead to the diversification of the economy which is quite necessary for the quantum growth of the economy. This proposition was enunciated by Adebayo Sanni-Omotosho (2018) when he opined that Nigeria and China currency swap will result to possibly diversification of the Nigerian economy and trigger also the emergency of many small scale industries. He went further to posit that such development will require inputs ranging from raw material to machinery and technical know –how.

In the microeconomic landscape concepts, it is envisaged that currency swap will make it possible for companies within
China and Nigeria to be very flexible to exploit their comparative advantages in their ability to borrow. Therefore, currency swap leads to secure cheaper debt by borrowing at the best available rate regardless of currency and then swapping for debt in desired currency using back –to- back-loan. More especially, the currency swap will generates a large credit exposure, because of exchange and e-exchange of national principle amounts. Nigeria companies will have the ability to asses’ loans both in China and Nigeria alike which will be guarantee by the government of both countries. There is also big advantage in the pricing mechanism as a discounted cash flow analysis is employed which lead to obtaining the zero coupon version of the swap curves. The transaction of the currency swap is transacted with no net value, over the life of the instrument. It will be a positive instrument to both Companies of countries to hedge and reduce against exchange fluctuations.

Given the importance of collateral to the financial system at large, cross-currency swaps are important as a hedging instrument to insure against material collateral mismatch and devaluation. It will real protect the Nigeria companies from the risk of fluctuation from the third currency. It has the ability of giving both companies in the country dealing in swap currency to extra flexibility to exploit the comparative advantages in their respective borrowing markets, also provide them with the ability to exploit other markets and make a reasonable economic choice within across a network of currencies and maturities.

In conclusion according to CBN “It will also assist both counties in their foreign exchange reserve management, enhance financial stability and promote broader economic cooperation” CBN (2018).

IV. THE DEMERITS OF CURRENCY DEAL:

Despite the fact that currency swap hold a lot of prospects for both counties, however, in dealing with the currency swap transactions, it becomes absolutely necessary that the Government should be extremely careful in the currency swap with China. As some Critics after rigorous analysis, rightly pointed out that the deal may be a poisonous challiss offered to Nigeria for China to penetrate and exploit the economy of Nigeria to their best interest; thereby making Nigeria Economical dependent on China. The point stands that, this is a deal between two unequals; a bigger China and smaller economy like Nigeria, strategically the China government will use the deal to monopolies our economy to their best interest and by the time Nigeria will realize it, it will be too late.

Another nagging problem is whether Nigeria has adequate competent and knowledgeable manpower to drive the project positively well. It is a known fact that many of the Nigeria technocrats are corrupt and they will be more interested in the projecting their selfish interest than that of the country, in the implementing of the project to detriment of Nigerians. Even some corrupt bank officials may be out to be compromised before they issue the companies with the Chinese currency, and that will increase the cost of transactions by the companies and the price of the imported goods higher than anticipated and may defeat the thrust of the policy.

Nigeria economy is just growing and therefore very fragile and care must betaken that the growing industries which are the mainstay of the economy will not be stiffen at their infancy through dumping from the Chinese companies. That will discourage the growth of Small and Medium Enterprises in Nigeria and exacerbate the massive unemployment in Nigeria as well. This view was well articulated by Adebayo Sanni-Omotosho (2018) when he posited that the disadvantages of the deal are that it may encourage dumping and kill fledging industries, especially if the swap concentrates on consumables goods. It may necessitate dumping which may destroy startups and other industries which are the mainstay of the economy more especially if the industries are consumables. In view of the fact that over the period Nigeria has been registering negative trade balance with China in the last five years, and if there no correspondent increase in the export it means it will continue to register a continuous trade deficit with China.

To this end, the deal may be of a great benefit in the development of the companies of businessmen in Nigeria, but due to the incompetency, weakness, and corruption in Nigerian and the poor oversight of the economy, it may hurt the economy if such key factors are not taken into considerations. And escalate the depreciation of the currency. In such scenario, Nigeria will be worse off economically with the tendencies of increasing the poverty in Nigeria.

Another important point that stands in favor of the currency swap with China is the fact, it will eliminate to considerable extent the use of dollar, it is suggested that it may not have the ability because the Nigeria imports from China consists only 20 percent. It must be pointed out that Nigeria may not be able to manage or oversees what China does with naira over there. It is a very big possibility that China may manipulate our currency, thereby making Nigeria worse off economically in the deal. Some Critics pointed out that China will do anything possible to maximize their profit though the deal.

V. RECOMMENDATIONS

It is imperative that Government should banned unwanted items from being imported from China, in order to prevent dumping. Those goods that can easily be produced by the industries in Nigeria should be banned in order to encourage startups industries and protect the old industries as well. The CBN should allow only importation of goods enlisted in the agreement. However is more advisable and preferable that industrial goods should be allowed instead of consumers’ goods.

The government should be proactive in putting a strong policy on ground for the supervision and the implementation of the scheme to ensure the efficient and effectively operation of the scheme to the best interest of the country, to prevent the
Chinese from monopolizing the economy. In the signing of the agreement the government must be meticulous enough that only the interest of Nigeria should be protected and have the mechanism to escalate economic development and sustainable growth. In that way it will be a catalyst and the driving force of the economy. This in “addition requires the government to put surveillance on boarders to prevent smuggling and other unhealthy economic activity” Adebayo (2018) opined.

Nigeria needs to develop competitive advantage in the production of certain exportable goods that China currently imports in order to derive full benefit from the currency swap.

It is germane to note that CBN is very proactive to enter into currency swap agreement with China, and very efficient policies must be enunciated that will create positive operation of the scheme to ensure that Nigerians benefit maximally from the agreement. Most importantly care must be taken that corruption that has been the bane of any good policy that is formulated should be nipped in the bud in the formulation and the implementation of the scheme. Therefore, it is critical to point out specifically that Supervision Department of CBN must intensify its efforts to enforce compliance among the operating banks, to sanction any bank that involves in corrupt and sharp practices to circumvent the policy with a view to make undue profit. And the bank officials that aided to perpetuate such fraud must face the legal consequences. This will sound a note of warning to both the banks and the officials to ensure strict compliance in implementation of the policy without looking for self-profit.

VI. CONCLUSION

Economic Analysts, after considering the entire factors stated above, are of the views that Nigeria and China Currency swap agreement is a step in the right directions because of its strategic importance on the economy of both countries, if it is well implemented. It will generate multiple economic advantages. The Monetary authorities maintained that the deal will appreciate National currency, if dollar is sidetracked in any transaction with China. It will go a long way to stabilize both currencies, and will help the economic planners to predict accurately well the direction of the economic metrics. More especially it will aid the businessmen with parameters to reduce risk embedded in the fluctuation of the foreign currency, this will increase their profits which if all things being equal will be plough back to their various companies finances to grow them.

Conclusively, it can be categorically stated that hence the positive impacts on the both microeconomic and macro economic level are more than the negative impacts. Therefore is highly recommended for Nigeria to undertaking swap deal with China.

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